Plan and Budget: 2015/16

Financial Services Compensation Scheme

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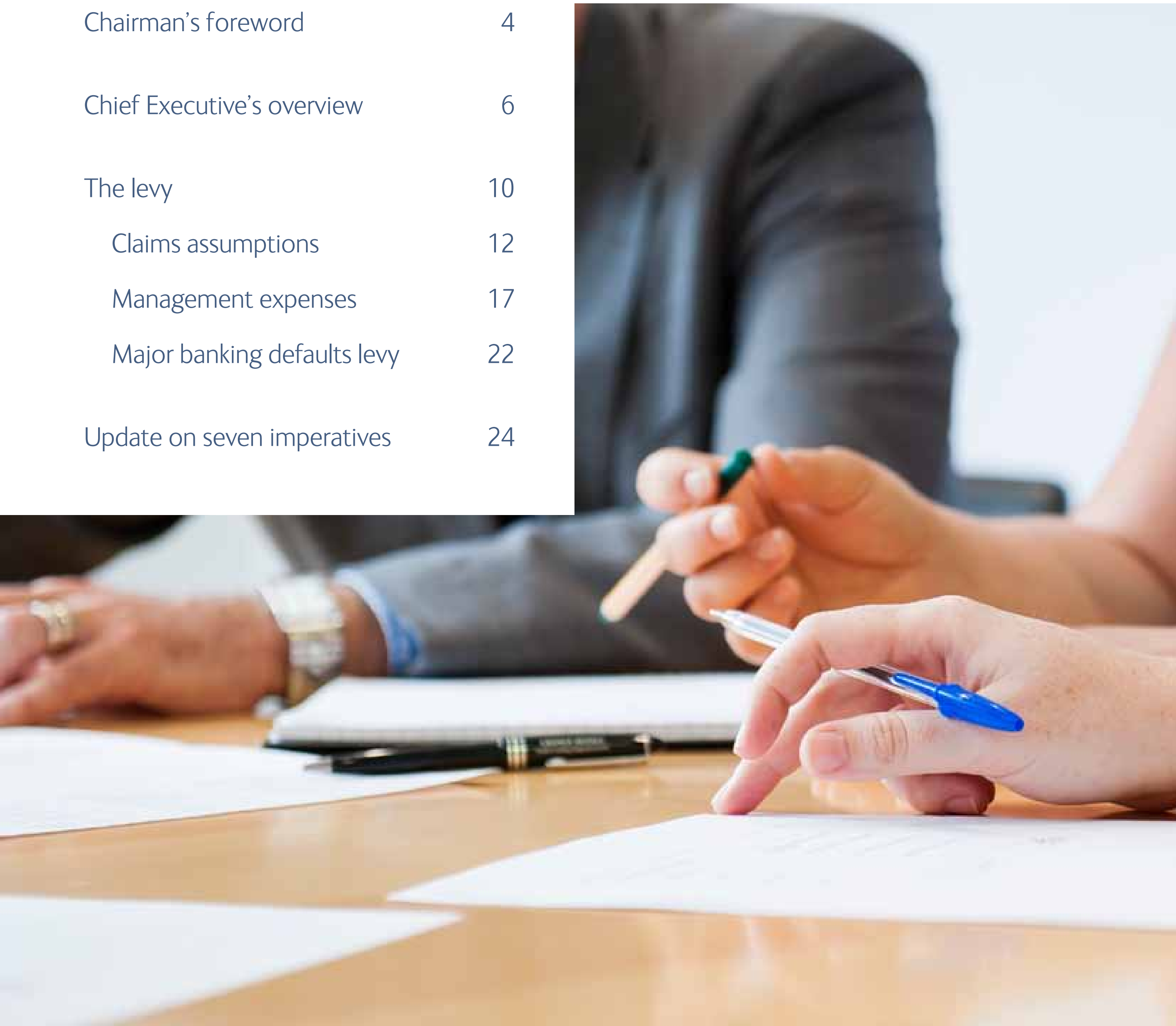


Chairman's foreword

Lawrence Churchill
Chairman

Last year we launched our five year *Vision for a Confident Future*. In it we set out seven imperatives to ensure FSCS meets both its stakeholders', and consumers', expectations. To remind you, those imperatives are:

- Modernising our service to consumers
- Diversifying how we deliver compensation to provide maximum convenience and continuity for consumers
- Raising awareness of FSCS protection to boost confidence
- Improving value for money, transparency and accountability
- Achieving excellence as a creditor to maximise the value we recover from failed businesses
- Deepening contingency planning to be ready to respond to failures alongside our key Partners
- Engaging our people and our organisation to be even more agile and professional

I am pleased to report we have made good progress over the past year in these areas, while also facing challenges. Mark Neale provides his thoughts on our work in his overview. You will also find more detailed accounts of our progress from page 24 of this document.

As Chairman, I'd like to focus on two of these imperatives in particular.

The first is our commitment to raising awareness. This sometimes attracts critical scrutiny because it is often assumed that we are spending levy payers' money to promote FSCS.

We are not. Our objective is instead to underpin financial stability and confidence in financial products by ensuring that consumers understand the protection we provide. Without this understanding consumers may avoid useful products because they assume they are riskier than they truly are, or, alternatively, take risks unknowingly because they assume FSCS can protect them when we can't.

£3.6m
marketing spend

With this in mind, our initial effort has centred on deposits to make sure, in any crisis, that liquidity problems are not made worse by depositors seeking to withdraw needlessly funds up to £85 000 which are fully protected by FSCS.

The Government's reforms on retirement saving – which come into effect from April – underline the need now to extend awareness further. Among other things, people nearing retirement and making crucial decisions about the investment of their pension pots will need to understand the scope of FSCS protection for the range of financial products they might choose. We shall work closely with the Pension Advisory Service and others to achieve this.

There is another point I should make about raising awareness. We believe the "heavy-lifting" should be done by the industry itself, not through FSCS spending. So, yes, we prime the pump with some relatively modest marketing spend of £3.6m, but we look to banks and building societies to inform their own customers about our protection, including by incorporating FSCS material into their marketing. Cooperation with the industry is central to our strategy.

And that brings me to the second imperative: value for money.

The FSCS Board never loses sight of the fact that we are funded by levy payers and must be able to demonstrate that we are achieving our statutory objectives efficiently and effectively.

So the Board has asked the Executive Team to develop a clear value-for-money strategy to support this imperative. That strategy is now in place. We are already seeing benefits, including from a more strategic and professional approach to the procurement of external services, including the outsourced handling of claims, which account for one quarter of FSCS's operational budget.

As we move into 2015/16 I shall be looking to FSCS to publish more and better information to enable our stakeholders to judge for themselves the progress we're making in this respect.

Chief Executive's overview

Mark Neale
Chief Executive

£6m fall in operational expense

Welcome to our Plan and Budget 2015/16.

Transparency is very important for FSCS and this publication enables us to lay out clearly our plans for the year ahead. It is also an opportunity to report against our five year Vision for a Confident Future and the seven imperatives we published last year. We think it is important that you, as levy-payers, can see and understand the future direction of FSCS; we are grateful for your continued support.

Our first priority for the year ahead will, of course be to deal quickly, accurately and responsively with the claims we receive from consumers.

As always, there is a significant measure of uncertainty about the nature and volume of claims, but it is already clear that the trend, which I highlighted last year, of growing claims arising from bad advice to switch pension savings into self-invested personal pensions (SIPPs) will continue. So far, we have compensated eligible investors for the pension losses incurred. Many of these investors have also, however, suffered significant investment losses as a result of advice to invest in risky, non-standard assets such as overseas property developments. FSCS is now close to finalising its view about whether these losses too are eligible for compensation. If we conclude that compensation is due for such investment losses, the costs of these claims falling on Life and pension intermediaries will rise significantly above our current forecast. We shall, accordingly, update our current forecast when we publish final levy numbers in April.

Subject to this uncertainty, we expect to raise a levy of £287m for 2015/16. That will fund both the compensation costs we expect to incur and our management expenses budget for the year ahead of £69m – down from £75m this year. The costs of running FSCS are set out in greater depth in the Management Expenses Budget on page 18. The main points are that we're reducing our investment in strategic change as we wind down our investment in enhancing FSCS's capability. We will also be spending around £4m less on major recoveries as we move into the next phase of our Keydata action.

This publication is supported by the joint Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) consultation paper issued on the annual FSCS management expenses levy limit.

As important as FSCS's service now, is the Scheme's ability to respond efficiently in future to new challenges and rising consumer expectations. So, in line with our five year strategy, our Business Plan for 2015/16 takes forward work to enhance FSCS's capability.

Central to this is modernising our service to consumers - the first of the seven imperatives shaping our strategy. During the past year we have invested a great deal of time and effort on the design, build and implementation of Connect, a new streamlined claims handling system and online claims portal for consumers. Connect is the single biggest business and systems transformation FSCS has ever undertaken and will provide the foundation for FSCS's operations for years to come. Consumers will be able to make claims and check their progress online. Connect will also deliver important efficiency, scale and control benefits to FSCS because claims will be dealt with electronically. Our outsource partners, who handle the majority of claims, will also use the same platform, helping to streamline processes.

During the course of 2014, we identified a number of existing and potential design and testing issues with Connect that we needed to address. We knew this would result in delay, so we revised our plan and have moved our launch date for Connect to April 2015. Connect will also cost more than we expected, although we have contained this additional cost within our budget for 2014/15. We have budgeted £3.6m for the next phase of Connect - which we're calling Connect 2 - in 2015/16.

The counterpart of modernising our own claims handling capability is our work, with our regulatory partners, to find new ways of delivering compensation which secures continuity of service for consumers. A cheque in the post, however swiftly delivered, does not achieve that.

With this end in view, both the industry and consumers will be interested in our work in 2015/16 to implement the proposals contained within the PRA's Depositor Protection consultation paper (CP20/14) and Policyholder Protection consultation paper (CP21/14).

The proposed changes within the Depositor Protection consultation paper include improvements to FSCS protection: namely, additional cover for temporary high balances such as the proceeds of a house sale or other life event; and, continuity of access by transferring accounts from a failing firm to another provider.

Alongside these changes to protection, we need to update our data handling capability. Specifically, we must ensure that we are able to verify the Single Customer View (SCV) files produced by banks, building societies and credit unions which underpin FSCS's ability to compensate depositors within seven days in a resolution. We will be working on the developments of SCV files and the verification process with the banks and building societies and will be reaching out to the credit union sector too.

11%
increase in employee satisfaction

FSCS also remains committed to pursuing recoveries in order to reduce the costs of compensation to levy payers. Our recoveries strategy is working. The significant recoveries we have already made demonstrate this. In December we gave back £50m to fund managers following the 2010 failure of Keydata, and recovered £1.36bn for FSCS and HM Treasury from the estate of Icesave, one of the Icelandic banks to fail in 2008.

Finally, I would like to touch upon another important imperative: to engage our people. In order to help support this imperative we identified six key objectives; you will find the details on page 30. One of these objectives relates to learning and development, so I am pleased to report that we have delivered more in the last year than we have delivered in the previous two years.

This success is reflected in our annual People Survey which showed an 11% increase in employee satisfaction in the quality of the learning opportunities that we provide. We will continue to invest in our people.

I would also like to highlight that FSCS has become actively involved with a number of equality programmes including Opportunity Now, Race for Opportunity, Stonewall Diversity Champions and most recently, the 30% Club. The 30% Club aims to increase women's success at work and create a better gender balance for leadership progression. I recently had my first session mentoring someone and it was fascinating to talk over strategies and share insights into the successful women leaders I've been fortunate to work with.

I am confident the commitment of FSCS's people to excellent service, along with the launch of Connect, will help us achieve our aims into 2015/16 and beyond.

Connect programme will allow us to respond quickly, efficiently and accurately to consumer claims for compensation.

- During the past year we have invested a great deal of time and effort on the design, build and implementation of Connect.
- We identified a number of issues with Connect that we have addressed by revising our plan and moving our launch date to a new date in April 2015.
- As part of Connect we will launch an online claims portal for consumers.
- A key investment of £3.6m in 2015/16 will fund the next phase of the Connect programme.
- An important part of the Connect programme involved reorganising our Operations division. We are also recruiting staff with new skills which are more closely aligned to our operational challenges.

The levy

Since 1 April 2014, except in the case of the deposit taking class, FSCS has been able to levy the greater of one-third of the next 36 months' expected compensation costs or the costs expected over the next 12 months from the date of the levy. These costs are subject to the annual class thresholds. This is the second year FSCS has used the 36 month funding model.

FSCS expects the 36 month model to help reduce the volatility of annual levies and the likelihood of interim levies, so giving the industry greater certainty. Our approach is based largely on past claims experience, which we adjust to reflect current claims trends and market intelligence. When setting the levy, FSCS reviews the claims and costs of the previous years and compares those against the information available to inform the assessment of costs expected over the next 36 months.

£287m indicative annual levy for 2015/16

The 36 month compensation cost levy has a five step process as follows:

1. calculate the average figure for compensation paid by the class over the last three years;
2. identify, and adjust for, any inflating or exceptional factors in the last three years (where the level of costs is not expected to be repeated);
3. add costs of known or expected defaults for which claims have not yet been paid, but have been identified as payable over the next 36 months;
4. factor in any new or current upwards or downwards claims trends expected over the next 36 months; and
5. account for the opening balances for each class.

Management expenses attributable to specific industry sectors are then added to the final amount required at the end of the five step process. The forecast costs for management expenses, including the outsourcing costs, are calculated for the following 12 months (not 36 months). Each year the PRA and FCA consult on FSCS's annual management expenses levy limit.

The annual limit on the levy that can be raised on each industry sector – the class threshold – applies to both the specific costs element of management expenses and compensation costs. Where the aggregate compensation costs and management expenses exceed a class threshold, the annual limit cap applies.

Annual Levy 2015/16

The indicative 2015/16 annual levy amounts to £287m. This compares to the £276m final levy raised in 2014/15. We will review and confirm the annual levies in April 2015.

Our calculations

To be able to levy for the higher of the expected costs under the 36 month approach or the traditional 12 month basis, we calculated the expected compensation costs on both bases. As previously explained, we use a five step process to calculate the 36 month compensation costs. In each relevant class we have applied the historical three year average compensation costs, except for life and pensions intermediation and home finance intermediation, where the level of claims we are receiving indicate a rising trend. We have therefore uplifted the levy amount for those classes to reflect this trend. We have not deducted from the calculations any costs for past exceptional items. Figure 2 sets out the alternative figures. and we take the higher of the two, except for insurance intermediation where we believe there is a falling trend in claims. The amounts in figure 2 are then adjusted for opening balances, management expenses and recoveries by funding class. The result of this is the funding requirement for the levy. The highlighted numbers are the indicative compensation amounts to be levied for in 2015/16. The effect on the forecast fund balances for 2015/16 of raising these amounts is shown in figure 3. Any surplus/deficit created by this levy will then form the opening balance of the calculation for 2016/17.

Figure 1: 2014/15 final levy compared with 2015/16 indicative levies by funding class

Funding classes	2014/15 final levy (£ million)	2015/16 indicative levy (£ million)	Variance (£ million)
Deposits (SA01)	16	**10**	**6**
General Insurance Provision (SB01)	71	**68**	**3**
General Insurance Intermediation (SB02)	38	**-**	**38**
Life and Pensions Provision (SC01)	-	**-**	**-**
Life and Pensions Intermediation (SC02)	33	**57**	**(24)**
Investment Provision (SD01)	-	**-**	**-**
Investment Intermediation (SD02)	112	**125**	**(13)**
Home Finance Intermediation (SE02)	2	**3**	**(1)**
Base costs	4	**24**	**(20)**
Total	**276**	**287**	**(11)**

Figure 2: Forecast compensation costs by funding class

	2015/16			
Funding class	**12 month forecast**	**3 year historical average**	**Trend**	**Forecast Used in Levy**
Deposits (SA01)	4	n/a	n/a	4
General Insurance Provision (SB01)	104	91	n/a	104
General Insurance Intermediation (SB02)	10	38	-	10
Life and Pensions Intermediation (SC02)	51	27	50	51
Investment Intermediation (SD02)	107	120	n/a	120
Home Finance Intermediation (SE02)	1	1	2	2
Total	**277**	**277**		**291**

Claims assumptions

In forecasting the claims to FSCS over the next 12 months we make certain assumptions about claims/ default volumes and trends where we have sufficient information to quantify the expected numbers. The outsourcing expenses within the management expenses are also based on these assumptions about our likely future claims.

Our assumptions reflect our experience of current claims trends as well as other information from the FCA, PRA, the Financial Ombudsman Service and the industry. Clearly, these assumptions may change over time. Recent years have shown that some unexpected larger failures have significantly impacted our estimates. Accordingly, we continually monitor claims trends and default prospects and review and update these assumptions, to help us determine the resources and expenses required to pay the claims we expect within target service levels.

We expect to see a reduction in overall claims volumes in 2015/16, reflecting lower volumes of new PPI and mortgage endowments claims. However, FSCS is seeing increasing volumes of claims in relation to pensions advice, particularly claims in relation to advice to invest into Self Invested Personal Pensions (SIPPs). We expect this trend to continue and there is considerable uncertainty as to the amount of compensation we may have to pay in relation to these claims. Investment claims volumes are expected to reduce, as FSCS

Figure 3: Forecast funding requirements by funding class

Funding class	Adjusted Opening Fund Balance 01/07/2015 (£ million)	Compensation 1/7/15 – 30/6/16 (£ million)	Recoveries (£ million)	Mgt exps 1/4/15-31/3/16 (£ million)	Annual Levy receipts 2015/16 (£ million)	Forecast Closing Balance 30/06/2016 (£ million)
Deposits (SA01)	9	(4)		(15)	10	0
General Insurance Provision (SB01)	37	(104)	7	(7)	68	1
General Insurance Intermediation (SB02)	19	(10)		(7)	0	2
Life and Pensions Provision (SC01)	0	0		(0)	0	0
Life and Pensions Intermediation (SC02)	0	(51)		(6)	57	0
Investment Provision (SD01)	3	0		(0)	0	3
Investment Intermediation (SD02)	(4)	(120)	13	(12)	125	1
Home Finance Intermediation (SE02)	(0)	(2)		(1)	3	0
Base costs	(2)			(21)	24	1
Total	**64**	**(291)**	**20**	**(69)**	**287**	**8**

Figure 4: Claims assumptions 2014/15 and 2015/16

Sub class	Default/Type of claim	2014/15		2015/16	
		New claims assumptions	Estimate of completed claims	New claims assumptions	Estimate of completed claims
SA01	Deposits*	5,584	5,585	10,000	10,000
SB02	Insurance Intermediaries (inc PPI, but excluding Welcome Financial Services Limited)	6,682	7,041	4,230	4,230
SC02	Life & Pensions Intermediation	4,958	5,194	5,407	6,207
SD02	Investment Intermediation	10,325	11,223	5,353	7,153
SE02	Home Finance Intermediation	559	490	600	600
Total claims* exc insurance payments		**28,108**	**29,533**	**25,590**	**28,190**

Notes:

* Excluding major bank failures

12,000
new insurance claims expected in 2015/16

resolves the claims in relation to significant recent failures such as Catalyst and the CF Arch Cru funds. However, FSCS will continue to be faced with a significant number of varied and often complex claims in relation to investment advice given by intermediaries. Where there continues to be volatility in claims levels, we will factor these into our assumptions as numbers become clearer.

Our assumptions about our likely future claims are shown in figure 4.

Deposits (SA01)

Based on our recent experience of credit union failures, we allow for a small number of credit union failures in the year ahead. Our assumptions do not provide for the failure of any other deposit taker(s) although we have in place the appropriate plans to deal with larger deposit taker failures if necessary.

General insurance provision and intermediation (SB01 & SB02)

We expect PPI claims to continue to be a significant workstream for FSCS in 2015/16 but at reducing levels compared to recent years. This mirrors the experience of the Financial Ombudsman Service and wider industry. As a result of falling claims and a higher opening fund balance, we do not expect to raise a levy against the general insurance intermediation sector in 2015/16.

For general insurance provision we expect that 2015/16 will see an increase in compensation costs. On the estates of Chester Street, Builders Accident Insurance and Independent Insurance we continue to see claims costs arising from significantly increased numbers of noise induced hearing loss claims. We expect compensation for mesothelioma claims will continue at a rate similar to last year. We will also continue to receive claims arising from the 2012/13 defaults of Municipal Mutual Insurance and Lemma Insurance Europe Ltd, the 2013/14 default of Millburn Insurance Company Ltd, as well as the recent 2014/15 defaults of Balva AAS and European Risks Insurance Company. The majority of our work on Balva, European Risks Insurance Company and Lemma will be in respect of claims arising from solicitors' professional indemnity policies. We assume that approximately 12,000 new insurance claims will be made in 2015/16. For general insurance provision, FSCS is primarily responsible for making payments to claimants, with claims being processed by run-off agents.

5,407
Life and pensions claims expected in 2015/16

Life and pensions intermediation (SC02)

FSCS has seen increasing numbers of claims against independent financial advisors in relation to life and pensions advice. In particular, we are seeing claims in relation to advice given to transfer funds from existing pension schemes to SIPPs. In many cases the SIPP fund was then invested in risky, non-standard asset classes, many of which have become illiquid. FSCS's experience of these claims is consistent with warnings published by the FCA in relation to SIPPs and the conduct of some firms. This trend is expected to continue in 2015/16.

FSCS expects to receive 5,407 such claims in 2015/16, an increase compared with 4,958 such claims expected in 2014/15. However, this is a provisional forecast based on current expectations, and it is possible that claims could increase above these levels. In addition, it is possible that the forecast compensation costs could also materially increase, particularly in the event that FSCS compensation payments include investment losses resulting from pensions advice received by investors. This could have a significant impact on the costs falling to life and pensions intermediaries. FSCS will keep claimants and levy payers updated on developments with implications for the levy.

Investment provision and investment intermediation (SD01 & SD02)

Claims against investment intermediaries are expected to reduce in numbers in 2015/16 as a result of the end of recent significant work-streams such as claims against Catalyst Investment Group Limited and in relation to advice to invest into CF Arch Cru funds. However, other types of investment claims will continue to be received in steady volumes.

FSCS is not currently expecting claims in relation to investment fund management activities in the next financial year.

Home finance intermediation (SE02)

We do not expect any significant increase in claims volumes for the rest of this year and into the next. We maintain similar assumptions for 2015/16.

Management Expenses

Management expenses budget

Figure 5 breaks down FSCS's management expenses budget for 2015/16 alongside the budget for 2014/15 and the latest expected outturn for this year.

Similar to last year, we have further split the 2015/16 management expenses budget between firms regulated by the PRA and FCA in figure 6.

The FSCS Board has approved a management expense budget of £69.1m which is £5.5m lower than the 2014/15 budget and £4.8m lower than the latest forecast for 2014/15. The PRA and FCA are consulting on the FSCS management expenses levy limit.

The key drivers of the 2015/16 budget and future direction of travel are:

- outsourcing costs in 2015/16 include, for the first time, an estimate of the costs of handling claims against the estate of Independent Insurance, which FSCS expects to take over from the administrator during the course of the year;
- downward pressure on our **operational cost** base as our Connect investment reduces outsourcing costs and enables a modest fall in headcount: transitional costs offset this in 2015/16, with the full impact of this to be felt in future years.;
- a substantial reduction in **Strategic Change investment** as we wind down the investment in enhanced capability and scalability that began in 2010 with our investment in fast pay-out for deposits and reaches a peak this year with our investment in Connect; and
- a fall of around £4m in spending on **Major Recoveries** for our continued litigation against IFAs responsible for mis-advising consumers to buy Keydata products.

£4m

fall in spending on major recoveries

Figure 5: Management expenses budget

	2014/15 Budget (£ million)	2014/15 Forecast (£ million)	2015/16 Proposed Budget (£ million)
Continuing Operations			
- Staff costs	16.4	15.9	16.5
- Contractor costs (non-Change)	0.9	2.1	1.2
- Pension deficit funding	1.6	1.6	1.6
- Facilities	2.2	2.2	2.1
- IT	2.4	2.2	3.3
- Communications	4.1	4.1	4.2
- Legal & Professional	2.9	2.7	2.6
- External providers	0.7	0.8	0.8
- Other	0.3	0.3	0.3
- Contingency	0.3	0.9	0.3
Subtotal	**31.8**	**32.8**	**32.9**
Outsourced claims handling	11.0	10.3	12.1
Outsourced printing & scanning services	0.5	0.9	0.9
Operational total	**43.3**	**44.0**	**45.9**
Strategic Change Portfolio	16.3	18.5	12.4
Operational & Investment Expense total	**59.6**	**62.5**	**58.3**
Bank charges	4.9	4.1	4.8
Interest received	0.0	(0.1)	0.0
Keydata Investment Services Limited recovery expense	7.2	4.4	3.0
Major banking failure related Management expenses	3.0	3.0	3.0
Total Management expenses	**74.7**	**73.9**	**69.1**
Non-levied Reserve for Major Failure	5.3	5.3	5.3
Total Management Expense Levy Limit	**80.0**	**79.2**	**74.4**

£3.6m
investment in the Connect programme in 2015/16

Allocation to funding classes

The FSCS 2015/16 Management Expenses budget is split between the PRA and FCA industry sectors or funding classes. All costs have been identified as either "specific" or "base" costs and allocated to the relevant sectors.

The basis of the cost allocation is as follows:

i. costs that are wholly attributable to a type of business are allocated to that specific sector;

ii. overhead costs are split between sector-specific on the basis of the proportion of frontline staff full time equivalents (FTE), and base costs on the proportion of support staff FTE. The sector-specific overhead costs are then allocated across the classes using timesheet data; and

iii. total base costs have been split 50:50 between the PRA and FCA (who will then apply their overall class allocation matrix to spread between their fee classes) in accordance with the FEES rules (Handbook Section 6.4.5).

2015/16 Strategic change portfolio – improving FSCS's effectiveness and efficiency

FSCS is continuing to invest in its business to enable it to carry out its functions more effectively.

Of a total of £12.4m, the key investment of £3.6m in 2015/16 will be the next phase of the Connect programme. The Connect Programme had lifetime external cost as approved by the Board subcommittee in August 2013 of £12.2m. This increased to £15.7m during 2014 due to additional design requirements and the current predicted spend on the programme is £20.4m. This incorporates document scanning and transmission, increased testing and streamlining the data exchange with the outsourcers. This is being funded by savings and contingencies in other projects and the reprioritisation of work combined with lower spend on Keydata and other recovery expenditure which has not materialised throughout the year. As mentioned elsewhere in this document, the first phase is now planned to go live in the Spring of 2015.

The other main focus in 2015/16 will be on the need to implement the Deposit Guarantee Schemes Directive (DGSD). This includes the completion of the project to bring in-house the verification of SCV files. These provide a single, consistent view of each eligible claimant's aggregate protected deposits with the relevant firm and contain the information required by the Compensation rules in the PRA Handbook (COMP). This will enable us to provide a better service to banks, building societies and credit unions at lower cost.

Provision has also been made for certain new initiatives (e.g. the intranet upgrade and the HR and Finance systems upgrades) that require further analysis and a full business case prior to FSCS Board approval. These business cases will include value-for-money assessments, with careful appraisal and correct project governance ensuring the most appropriate path is taken during the implementation of the project .

Figure 6: Split of Management Expenses for 2015/16

	FSCS	PRA	FCA
Base costs total (£ million)	**21.0**	**10.5**	**10.5**
Specific costs			
- Deposits (SA01)	14.8	14.8	-
- General Insurance Provision (SB01)	7.2	7.2	-
- General Insurance Intermediation (SB02)	6.7	-	6.7
- Life and Pensions Provision (SC01)	0.3	0.3	-
- Life and Pensions Intermediation (SC02)	5.6	-	5.6
- Investment Provision (SD01)	0.3	-	0.3
- Investment Intermediation (SD02)	12.4	-	12.4
- Home Finance Intermediation (SE02)	0.8	-	0.8
Specific costs total	48.1	22.3	25.8
Total	**69.1**	**32.8**	**36.3**

Figure 7: Comparison of 2014/15 levies with forecast levies for 2015/16

	Actual Levies for 2014/15			Forecast Levies for 2015/16		
Defaults	**Loan interest cost (£ million)**	**Capital Levy (£ million)**	**Total Levy (£ million)**	**Loan interest cost (£ million)**	**Capital Levy (£ million)**	**Total Levy (£ million)**
Icesave	11	125	136	6	-	6
KSF	9	127	136	5	91	96
Heritable	1	8	9	0	-	0
LSB	3	39	42	1	-	1
Dunfermline	-	100	100	-	256	256
B&B	422	-	422	391	-	391
Total	**446**	**399**	**845**	**403**	**347**	**750**

£5.3m
proposed reserve for 2015/16

Major recoveries expenses – reducing the costs of the levy

The Scheme actively pursues opportunities to recover the costs of compensation wherever it is possible and cost-effective to do so. Keydata Investment Services Limited recovery costs are estimated to be £4.2m lower than the current year's budget at £3.0m. FSCS continues to pursue recoveries from intermediaries involved in the sale of Keydata products to mitigate the costs of compensation to levy payers. Significant recoveries have already been delivered. FSCS considers that continuing action will benefit levy payers.

In 2008/09, the Scheme paid out some £20.4bn to compensate customers in respect of the five major bank failures: Bradford and Bingley (B&B); Icesave; Kaupthing Singer & Friedlander; Heritable; and London Scottish Bank. This was funded by borrowing from HM Treasury, which FSCS is repaying with interest.

Following recoveries and initial capital repayments, the balance of these FSCS loans is approximately £15.8bn.

On page 22, we provide an update on the recoveries from these failures.

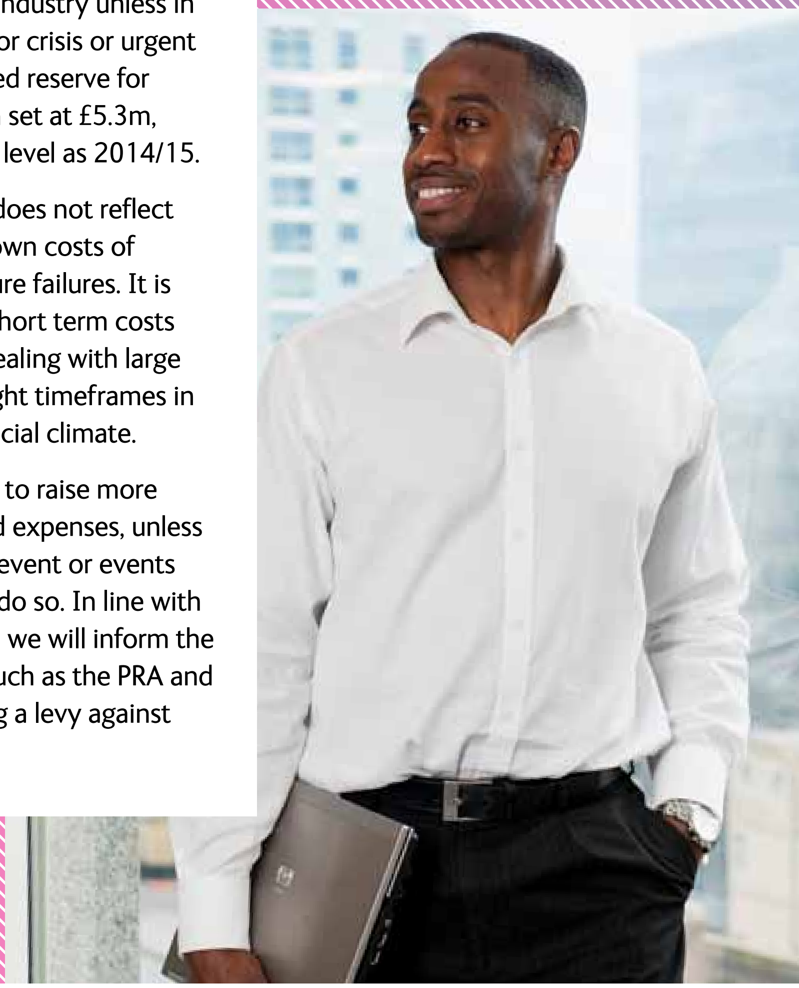
The budget for related management expenses is being held at £3.0m, which is the same level as 2014/15, to cover continuing work on these estates.

Non-levied reserve for major failure

The Management Expenses Levy Limit (MELL) includes an additional non-levied reserve, within which the Scheme can increase our management costs without further consultation in response to unforeseen failures. This reserve is not levied on the industry unless in response to a major crisis or urgent need. The proposed reserve for 2015/16 has been set at £5.3m, which is the same level as 2014/15.

The reserve level does not reflect the specific or known costs of any particular future failures. It is indicative of the short term costs of, for example, dealing with large defaults, within tight timeframes in an uncertain financial climate.

We do not expect to raise more than our budgeted expenses, unless there is a specific event or events that require us to do so. In line with our usual practice, we will inform the relevant parties, such as the PRA and FCA, before raising a levy against this reserve.



Major banking defaults levy

The major banking default levy is forecast to be £750m for 2015/16 (£845m in 2014/15). This is based on a number of assumptions detailed below.

In 2014/15 the loan interest accrued is forecast to be £403m, which will be levied in 2015/16. Under the loan arrangements which came into effect from 1 April 2012, the rates used to calculate the loan interest are subject to a floor. The floor is set at the higher of (a) the Debt Management Office (DMO) Gilt reference rate for a gilt of a similar maturity (and is selected consistent with the methodology previously published on our website), and (b) 12 month GBP LIBOR plus 1 percent

2015/16 will be the third and final year that FSCS will raise a levy to repay the capital of the non-B&B loans from HM Treasury. These are due for repayment on 31 March 2016. We have previously levied £363m in 2013/14 and £299m in 2014/15 to partially repay these loans.

In December we recovered a total of £1.36bn in additional dividend payments from the Icesave estate, increasing the recovery to almost 85%. FSCS's share of this was £435m with the balance due to HM Treasury. After allowing for the capital repayments already levied, this enabled FSCS to repay all the outstanding capital on Icesave, as well as the Heritable and London Scottish loans, and part of the Kaupthing Singer & Friedlander (KSF) loan. Accordingly, in 2015/16 we will need to levy about £91m to repay KSF by the due date, based on our estimate of dividends that may be received between now and March 2016. If the dividends we receive are higher or lower than expected, we will need to adjust the amount we levy on this and the other legacy estates.

For Dunfermline, FSCS is required to pay a contribution to the costs of the resolution in 2009. The industry will be aware that we have provided £552m in our accounts for these costs. £100m has been levied and paid to date. We are aware that the administrators are working on the closure of the estate and once the final dividends to creditors, in particular HM Treasury, are known, the amount of FSCS's contribution to the costs of resolution can be finalised. At that time FSCS may be asked to pay the balance of costs, less any interim payments made. Although the timing remains uncertain there is a strong prospect of the contribution being payable in the next couple of years. FSCS therefore proposes to levy for about one half of the estimated outstanding amount in each of the next two years - so that the 2015/16 levy will include about £256m which will be offered as an interim payment against the final contribution.

The total amount of the forecast major banking failure levy of £750m to be levied in 2015/16 (£403m interest, £256m Dunfermline contribution and £91m capital shortfall) is therefore based on a number of uncertain factors. The final amounts will not be confirmed until the summer of 2015. We will keep the industry informed of developments which may impact the levy. As before, the levy will be raised in July/August 2015 for payment to HM Treasury by 1 October 2015.

Figure 8: Major banking failure loans

Defaults	Drawdown to 31/12/14 (£ million)	Recoveries to 31/12/14 (£ million)	Recoveries received to 31/12/14 %	Capital Levy in 2013/14 (£ million)	Capital Levy in 2014/15 (£ million)	Loan balance at 31/12/14 (£ million)
Icesave	1,441	1,234	85%	183	125	-
KSF	2,581	2,142	83%	133	127	165
Heritable	465	437	94%	7	8	-
LSB	237	98	42%	40	39	-
B&B	15,654	-	0%	-	-	15,654
Total	**20,378**	**3,911**		**363**	**299**	**15,819**

Figure 9: Forecast recovery ranges (latest assumptions)

	Final recoveries expected			2015/16 Forecast		2014/15 Forecast	
Defaults	Final Recovery Range %	Recovery Rate Used In Model %	Capital Shortfall To Be Levied (£ million)	Recovery Rate Used In Model %	Shortfall To Be Levied By 31/3/16 (£ million)	Recovery Rate Used In Model %	Shortfall To Be Levied By 31/3/16 (£ million)
Icesave	90 - 100%	95%	72	85%	308	70%	432
KSF	85 - 86.5%	85%	386	84%	386	85%	387
Heritable	94 - 100%	95%	15	95%	15	95%	23
LSB	52 - 58%	55%	79	55%	79	50%	119
Dunfermline	n/a	n/a	577	n/a	356	n/a	200
B&B	100%	100%	0		0		0
Total			**1,129**		**1,144**		**1,161**

Update on seven imperatives

90% compensation paid within 10 working days of acceptance of an offer

How we're doing and what we'll achieve in 2015/16

a. Modernising our service to consumers

Claimant experience strategy

How claimants experience the Scheme is of primary importance to us. It is at the heart of our mission to provide a responsive and efficient claims service. Our strategy includes a set of principles to drive our design and delivery of our claims processes. These cover:

- focusing our claimant experience on minimising undue stress as claimants go through a claim;
- engaging our people and developing our culture in providing a deliberate claimant experience that is professional, trustworthy and fair;
- considering claimant needs in developing the channels we use to communicate with them while maintaining value for money;
- understanding the requirements of claimants with additional needs; and
- measuring and reporting the claimant experience to monitor performance against our strategy and to support improvements in our service.

We have developed a new claimant feedback survey to measure more accurately how we are doing. The strategy and underlying principles have been central to the process redesign which is being delivered through our Connect programme.

Meeting our service standards

Our top priority in 2015/16 is to provide a responsive and efficient service to people who have lost money as a result of the failure of a regulated financial services business.

Our current service levels reflect our understanding of what consumers want of FSCS, as well as the practical constraints we face in dealing with claims.

We set different target service levels for different activities and types of claims. Where possible, we give priority to people who may be facing hardship when making a claim. Many factors affect our turnaround times for claims. They include the type of claim, its complexity, the rules we have to apply and whether we have to wait for information from third parties (such as liquidators or other providers).

During 2015/16 we will look to review the service standards with a view to making changes for the year 2016/17. This will reflect the delivery of our Connect programme.

Figure 10: Our current target service levels for 2015/16

Activity	Claim Type	Service Standard
Answering Telephone Calls	All	80% within 20 seconds 95% within 90 seconds
Responding to Complaints	All	90% within 20 working days
Responding to other Correspondence	All	90% within 10 working days
Sending Application Forms	Deposits	Not applicable as application forms are not used for deposit claims
	Non-deposits	90% within 5 working days
Confirming Claim Decisions	Deposits	Majority of compensation within 20 working days (target 7 days)
	Welcome Financial Services Limited	90% of claims within 8 weeks of receiving a completed application form
	PPI	90% of claims within three months of receiving a completed application form
	Other	90% of claims within six months of receiving a completed application form Of the remaining 10%, no claims should be older than 12 months, unless exceptional circumstances apply
Making Compensation Payments		90% within 10 working days of acceptance of a compensation offer (where applicable)

Connect programme

Our Connect programme will achieve better customer service at the same time as improving operational efficiency and effectiveness. This will benefit both consumers and levy payers. We are redesigning and standardising our claims handling processes and developing online services. This will allow people to complete applications online and give them more choices when interacting with FSCS.

Specifically, the Connect programme will allow us to:

1. respond quickly, efficiently and accurately to consumer claims for compensation;
2. ensure that the Scheme operates as cost efficiently as possible; and
3. be ready to respond to defaults in the financial services industry to protect consumers and financial stability.

2014 saw the Connect programme progress through design and build phases into testing. We have just commenced the fourth phase of the programme, implementation, and are aiming to go live in April 2015. Going live will not only mean the ability internally to operate on the new platform with new processes, but also provide the same capability for our business process outsourcers (to be rolled out after go live). Most importantly, go live will also mean the launch of our online claims system. This will allow claimants to interact with FSCS electronically and to submit claims online for the first time.

In preparation for going live, FSCS has started to reorganise its structure. Recruiting the people we need to complete the new organisation is already more than ninety per cent complete. A number of people have also left the organisation and we thank them for their service and wish them well for the future.

Since the New Year, we have been conducting operational readiness activities with 'dry-runs' of the new processes and platform, and the new organisational structure. That structure will be at the heart of our capability to deliver the efficient and first-rate claimant experience for which Connect was conceived.

b. Diversifying how we deliver compensation to provide maximum convenience and continuity for consumers

During 2014 FSCS worked closely with the UK Authorities on the development of the PRA's depositor protection and policyholder protection consultation which opened in October 2014, and closed on 6 January 2015. FSCS awaits the outcome of the consultation and the expected policy statements during 2015.

The recast Deposit Guarantee Scheme Directive will introduce requirements for both FSCS and deposit firms, including a move to seven working day pay-out for depositors within the SCV file by 2023.

Other changes proposed within the Depositor Protection consultation paper (CP20/14) relate to continuity of access. The proposed requirements for firms are intended to ensure that continued access for depositors to FSCS-covered deposits remains feasible in the event of the failure of a firm. FSCS will continue to work with the PRA and the Resolution Directorate at the Bank of England on supporting the Bank of England's objectives for executing an orderly resolution under the special resolution regime.

The Policyholder Protection consultation paper (CP21/14) sets out a number of proposed changes to the rules for insurance policyholder protection.
The proposals were aimed at increasing the future operational effectiveness of FSCS in providing continuity of cover, payment of benefits falling due and compensation in the event of a failure of a firm. We are also keen to pick up any lessons or issues from the international debate on insurance resolution of both systemic insurers and generally for FSCS's role in both providing continuity for policyholders as well as claims settlement.

FSCS expects to continue to work closely with the UK Authorities during 2015/16 on implementing the proposals contained within the depositor protection and policyholder protection consultation papers.

As HM Treasury develops its response to the "Bloxham report" recommendations for the special administration regime for investment firms, we shall assist with the Authorities on the recommendations that impact

63%

adult awareness of FSCS or a protection scheme

FSCS. We shall also continue to keep the COMP Rules under review generally for improvements to the handling of claims and delivery of compensation.

c. Raising awareness of FSCS protection to boost confidence

Building confidence and stability through awareness

Consumer confidence is vital to competitive markets, as well as a healthy economy. Thus consumer confidence is central to financial stability. That is why our vision includes an imperative to raise consumer awareness of the protection FSCS provides. Independent research shows the more aware people are of FSCS, the more confident they are and the more likely to buy products.

Our focus in 2014/15 is on deposits. That's because this area touches almost everyone's lives every day. We will continue to focus on banks, building societies and credit unions in 2015/16 as we set out below. Only the deposits class funds the costs of the current consumer awareness programme.

We report regularly to the FSCS Board on consumer awareness and the key performance indicators for our programme and wider communications. They, along with our Consumer Awareness Advisory Panel, help to make sure that we head in the right direction. We have made sound progress towards delivering our vision commitments in 2014/15.

Chief among these is hitting our goal of achieving 70% awareness of FSCS or a protection scheme by 2019. Awareness currently stands at 63% of all adults, according to independent research by GFK NOP during 2014. This figure rises up to 76% for those people who recognise the campaign; it hits 71% for those who recognise our in-branch materials. So all of our channels are working together to boost awareness of FSCS protection.

In the current year we have:

1. introduced new creative designs;
2. developed the badge for the industry materials;
3. updated our audience research;
4. launched the next phase of the programme working with the Mail Online, and certain personalities to enhance and promote FSCS relevance;
5. established digital media including short videos.

We have retained the same budget for next year. We are currently developing our strategy for next year but anticipate the broad shape and scope of it may be similar to 2014/15. This means striving to engage people with our message using a range of channels, especially digital, which work well for FSCS.

Providing sound information to consumers about FSCS protection for temporary high balances and pensions will also feature in our work in 2015/16. The former results from the DGSD and the latter comes from pension changes following the budget.

There is a powerful role for firms to play in explaining FSCS protection to consumers at the time when it is most relevant for them. And that's when people are considering investing their pension pot or when they have a temporary high balance.

In both cases, our strategy is putting a strong emphasis on partnership as well as online information. We plan to provide the detailed information consumers need working in partnership with the industry and others.

For temporary high balances, the challenge is to strike a balance between pointing people to the information they need while not undermining the £85,000 limit message. We are working closely with our partners at home and abroad to do this. This includes working with other European schemes to develop consumer communications.

We have produced our messages for temporary high balances and are developing the materials to support our communications. We have done the same for the pension area.

There is potential for consumer misunderstanding about the pension changes as well. Depending on the choice a consumer makes the level of FSCS protection they have will vary. For example, if they decide to buy an annuity, the insurance limit will apply. If a consumer puts their pension pot in a bank, building society or credit union account the deposit limit will apply.

Once again, we are working with other organisations such as the Money Advice Service to help educate people about FSCS. They, and you, have the direct contact with consumers that can make a real difference. Working with the industry will again be key so that people get good information at the point at which they consider what they might do with their pension pot. FSCS will also publish information online for consumers and drive them to it from Google.

It is worth noting here that FSCS is not planning any radio, press or digital display advertising for either of these areas.

During the coming year we will also develop in more detail our plans for expanding our consumer awareness work into the insurance and investment areas in the future. At this stage, it is too early to predict the shape of this work. However, we expect it will emphasise working with industry. Advertising and marketing may not be the best option for this important area.

Working with the industry to build awareness

Our work with industry, to build consumer awareness and understanding, is critical for FSCS to deliver its mission: to be a well-understood service, which raises public confidence in the industry.

During 2014, as previously mentioned, we developed a new FSCS badge for use by the industry on simple products that FSCS protects such as current accounts, savings accounts or cash ISAs. The FSCS badge is already being used in FSCS's own advertising. We are now finalising an upgrade to all our materials, for the industry to use in all channels including mobile apps, websites, and the required in-branch materials. We will release all the necessary artwork on our website soon after the current Depositer Protection consultation paper is released as a policy statement, during 2015.

As we have already mentioned, our research, conducted by GfK NOP during 2014 showed that the presence of FSCS in bank, building society and credit union branches added significantly to overall awareness of FSCS. It showed that approximately one third of FSCS awareness was driven by the industry, with another third coming from our advertising and the final third from our PR.

With these new materials in 2015, we are aligning industry and awareness programme materials, so customers recognise FSCS protection whether they see it in-branch, in a newspaper, or hear about it on the radio.

We are also updating our e-learning module, incorporating the changes due to DGSD, to train front-line staff to provide accurate information about FSCS. Mystery shopping shows there is still much room for improvement on this.

We will continue to work collaboratively with financial services firms to bridge information gaps and help bring reassurance to customers. This in turn helps to restore trust in financial services. We need the support of firms to build the awareness which is critical to consumer confidence.

Three
key areas for improving accountability and transparency

d. Improving value for money (VFM) to drive value and strengthen accountability

FSCS is required by the Financial Services (Banking Reform) Act 2013 to have regard to the need to "ensure efficiency and effectiveness in the discharge of [its] functions" as well as a need to "minimise public expenditure....for the purposes of the Scheme."

A VFM strategy has been adopted during the year which focuses on driving accountability and transparency across the Scheme and we shall continue to develop this further throughout 2015/16 focusing on three key areas.

Firstly, we shall apply the value-for-money test to major strategic decisions. We continue to judge that outsourcing the great majority of claims represents the best value approach for FSCS given the volatility of our workload because it transfers the volume risk to organisations better placed to absorb it. We shall, however, keep this decision under review to ensure it is still appropriate as the complexity of our claims change.

Secondly, we are reviewing all business as usual activities to ensure VFM is adhered to in day to day working life. This involves reviewing all our processes and procedures to ensure they are performing in the most effective and efficient manner, alongside formulating benchmarks and metrics to measure the outputs. In addition to this, we are raising awareness by encouraging staff to talk about and be curious about what VFM means to them and start to challenge how things can be done to the greater benefit of claimants and our stakeholders; this has been evidenced in this year's budgeting round.

Finally, buying better and managing supplier relationships is an important area of value for the Scheme as about two thirds of the management budget is spent with third parties. This has been achieved by strengthening our procurement policy, processes and the way we interact with our suppliers, together with the introduction of category management strategies.

The overall impact of these and other activities is to demonstrate how FSCS uses its resources in a value for money way.

e. Achieving excellence as a creditor to maximise the value we recover from failed businesses

Making recoveries is a core FSCS function, and the industry recently received the benefit of recoveries attributable to Keydata claims. FSCS has made significant progress in its court proceedings against a large number of IFA firms in connection with the sale of Keydata Investment Services' financial products. To date, FSCS has achieved confidential settlements with a large proportion of the defendants in the proceedings who have elected to settle the claims against them for various reasons, and in turn FSCS has made substantial recoveries for its levy payers. FSCS is continuing its claims against the remaining defendants to maximise the prospects for additional recoveries and FSCS remains of the view that it has good claims against these defendants. A group of remaining firms has been identified as the "lead case defendants" and a further case management meeting shall be scheduled on or after 23 March 2015, at which time it is anticipated the Court will set the timetable to trial.

FSCS is also pursuing and remains alert to recovery opportunities across its portfolio, whether in insolvency proceedings and "exit" options, or for particular products where third parties may share responsibility for claimants' losses.

f. Deepening contingency planning to be ready to respond effectively to crises

To help ensure that we meet one of our key vision imperatives of deepening contingency planning, we work closely with the Authorities to identify and respond to emerging risks. This work is most developed in the deposit sector, with FSCS involvement at the appropriate stages of resolution and contingency planning, thereby providing greater assurance that we remain ready to respond quickly and efficiently to a failure. FSCS has agreed contingency plans, protocols and working arrangements in place with the Authorities including clarity of the roles and responsibilities of the different Authorities during a resolution process. FSCS is closely involved with its partners in the on-going development of resolution planning options to ensure the most appropriate outcomes for consumers, with minimum disruption to their ability to access their money.

Work continues with our partners to make sure that processes and contingency plans are developed and tested across the full range of FSCS protection. In addition attention is being given to improving FSCS's disaster recovery provision. These activities will reinforce our ability to respond to failure and ensure that in times of stress, there is no doubt about roles, responsibilities and responsiveness of the important safety net that FSCS provides.

g. Engaging our people and our organisation to be even more agile and professional

As reported last year, our Board approved our People and Organisational Development Strategy for 2013 to 2016 to help support this key imperative. We identified six key objectives against which we are tracking our progress. Our aims for 2015/16 in relation to these are outlined here.

Organisational development – The main focus of our work against this objective will be to ensure the successful implementation of the Connect Programme in 2015. A reorganisation of the Operations Division during the year, along with the recruitment of staff with new skills sets. As a result of this reorganisation a number of people have already left the Scheme. The new structure will be in place this month, and will be built around our end to end processes. During 2015/16 we will explore how we implement these organisational design principles across the wider organisation to enable it to be more agile and responsive to future demands and minimise key person dependencies.

Management development – This is designed to provide a cohesive and consistent approach to management across the different services at FSCS. A key deliverable has been the development and launch of our new competency framework. We worked with CEB SHL to develop their own universal competency framework for FSCS. In the coming year we will continue to roll out new interventions including a greater focus on Train the Trainer – using our managers to deliver and develop training to build management capability; the use of the Institute of Leadership and Management professional qualification framework and extending our Coaching Circles programme.

Learning and development – Our core learning and development programme is developed in consultation with Managers and is a complementary approach blending both traditional methods (training) with increased learning opportunities such as coaching, mentoring, and e-learning. Since launching our strategy in June 2013 on average every employee has enjoyed three days training per annum. Our People Survey showed an 11% increase in employee satisfaction with the quality of the learning opportunities that we provide. In 2015 we will launch Fuse – our new dynamic e-learning environment. Fuse combines social learning, performance and workplace support; distributed mentoring and coaching along with formal, fully tracked learning paths.

Recognition and reward – Human Resources undertook a comprehensive market pay review of salaries across the Scheme. We have also completed an Equal Pay Audit. We have most recently commissioned an analysis of our benefits expenditure and how we could maximise the return on this investment whilst increasing the amount of choice available to our employees. In the coming year we'll be putting this into practice and rolling out an online flexible benefits portal and total reward statements.

Talent management – We attended and facilitated talent management discussions across all the divisions. This has enabled us to build a comprehensive talent map of the whole organisation for the first time, and identify and agree actions to support their development. In the coming year we will work to provide a wider range of secondment opportunities with other organisations including the Bank of England, Money Advice Service, Financial Ombudsman Service and our legal partners.

Human resources services – We have worked collaboratively with our colleagues in procurement and legal to appoint a Master Vendor to manage all FSCS recruitment. After a rigorous procurement process we have appointed Hyphen, part of the Adecco Group. During 2015 we'll be rolling out a new reporting system called People Fluent across the Scheme to manage, track and report on all vacancies with significant improvements in management reporting to drive greater transparency and value for money.

In addition to these initiatives, as part of our ultimate aim to engage our people, we have become actively involved with a number of equality programmes to ensure we're leading by example. These include:

- Opportunity Now
- Race for Opportunity
- Stonewall Diversity Champions
- 30% Club
- Business Disability Forum

Very recently we have been accredited as an Investor in People following our first ever assessment for this against the core standard.

This *Plan and Budget: 2015/16* is for consultation. We welcome your feedback, which should be sent to planandbudget@fscs.org.uk by 20 February 2015.

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